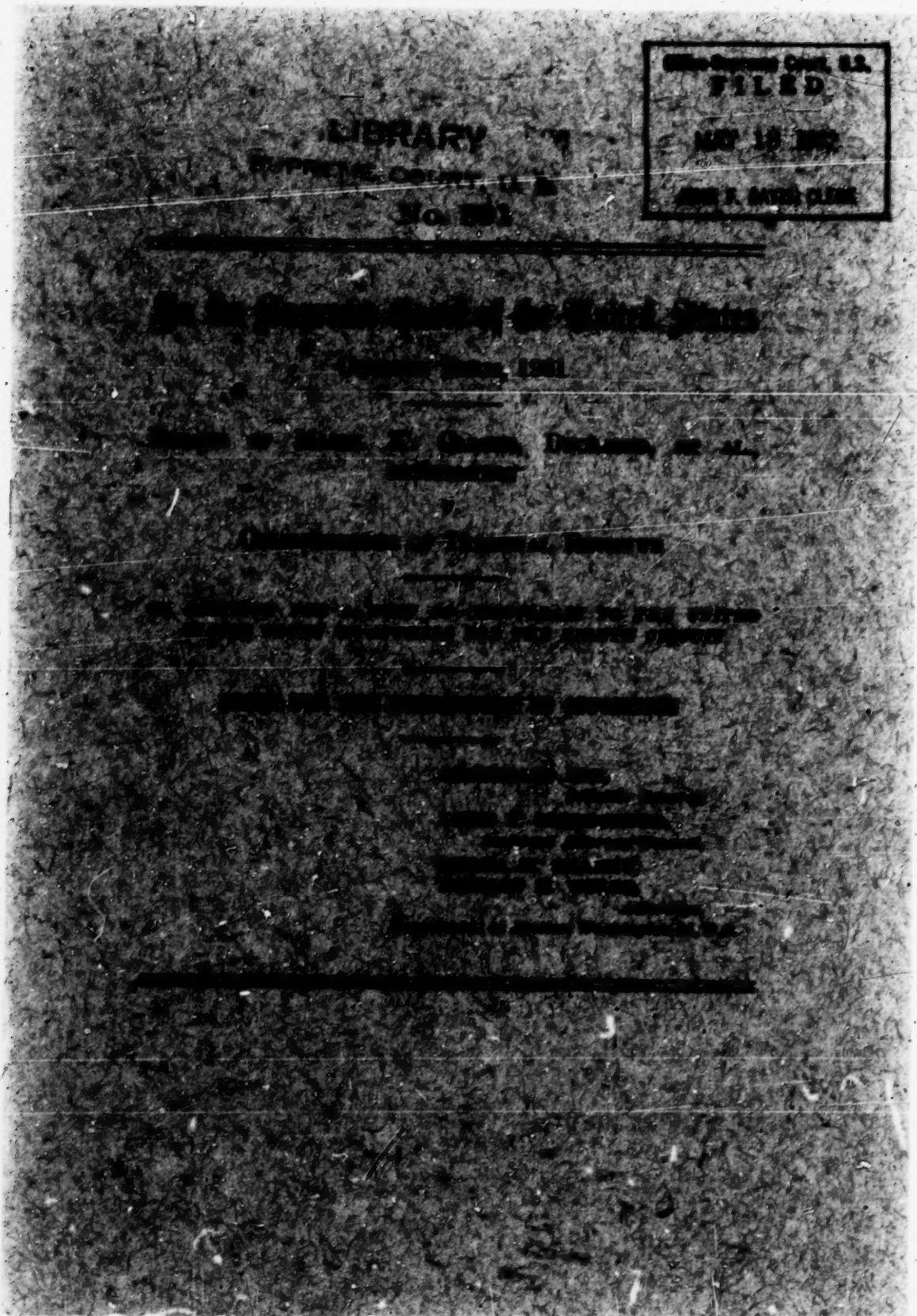
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INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statute and regulations involved	2
Statement	2
Argument	5
Conclusion	9
Appendix	10

CITATIONS

Cases:

Commissioner v. *Duberstein*, 363 U.S. 278 — 7

Commissioner v. *Glenshaw Glass Co.*, 348 U.S. 426 — 7

Comstock v. *Group of Investors*, 335 U.S. 211 — 5

Durkee v. *Commissioner*, 162 F. 2d 184 — 6

Raytheon Production Corp. v. *Commissioner*, 144 F. 2d 110, certiorari denied, 323 U.S. 779 — 6

United States v. *Safety Car Heating Co.*, 297 U.S. 88 — 6

Statute:

Internal Revenue Code of 1954:

Sec. 691 — 2, 8, 11

Sec. 691(a) — 11

Sec. 1014 — 2, 13

Sec. 1014(a) — 8, 13

Sec. 1014(c) — 8, 13

Sec. 1231 — 2, 5, 13

640382—62——1

Miscellaneous:

	Page
Rev. Rul. 55–463, 1955–2 Cum. Bull. 277	9
Treasury Regulations on Income Tax:	
Sec. 1.691(a)–1	2, 8, 14–15
Sec. 1.691(a)–2	2, 15–16
Sec. 1.691(a)–3	2, 16–17
Sec. 1.691(a)–4	2, 17–19

In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 891

ESTATE OF MABEL K. CARTER, DECEASED, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Supp. R. 3-24) are reported at 35 T.C. 326. The opinion of the court of appeals (Pet. A1-A9) is reported at 298 F. 2d 192.

JURISDICTION

The judgment of the court of appeals was entered on January 18, 1962 (Pet. A10-A11). On March 19, 1962, the court denied the petition for rehearing and motion for consideration of the petition by the court *en banc*. The petition for a writ of certiorari was filed on April 19, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTIONS PRESENTED

Taxpayers received, as distributions from a trust, certain sums which the trust had received in settlement of an anti-trust suit. The questions presented are:

1. Whether the court below erred in affirming the Tax Court's determination that the settlement proceeds represented damages for loss of profits (taxable as ordinary income) rather than proceeds from the involuntary conversion of capital assets (taxable as capital gain under Section 1231 of the Internal Revenue Code of 1954).

2. Whether the courts below erred in holding that the two taxpayers who received portions of the settlement proceeds through inheritance of beneficial interests in the trust had no adjusted basis under Section 1014 to be deducted from the settlement proceeds.

STATUTE AND REGULATIONS INVOLVED

The pertinent portions of Sections 691, 1014, and 1231 of the Internal Revenue Code of 1954 and Sections 1.691(a)-1, 1.691(a)-2, 1.691(a)-3, and 1.691(a)-4 of the Treasury Regulations on Income Tax (1954 Code) appear in the Appendix, *infra*, pp. 11-19.

STATEMENT

Mabel K. Carter owned the Liberty and Sedalia Theatres in Sedalia, Missouri, and engaged in the business of exhibiting motion pictures at the Liberty Theatre between September 15, 1940, and May 14,

1941.[1] On the latter date she ceased operation, because the business was suffering losses, and leased the two theatres to the Fox Ozark Theatre Corporation (R. 9–10; Supp. R. 6).

On October 21, 1952, Mabel K. Carter executed a trust instrument in which she irrevocably assigned to herself as trustee all of her claims, rights, and causes of action under the anti-trust laws against major motion picture companies. Under the trust she, Emma M. Yollrath, and the surviving individual taxpayers acquired vested beneficial interests in the property, corpus, and income of the trust in specified percentages (R. 10; Supp. R. 6–8).

On December 9, 1952, Mabel K. Carter, as trustee, filed a complaint in the United States District Court for the Western District of Missouri against certain motion picture manufacturing and distributing companies, seeking treble damages under "Section 4 of * * * the Clayton Act." The complaint alleged many acts of the defendant motion picture companies in violation of the anti-trust acts and sought to recover damages suffered by Mabel K. Carter as owner and operator of the Sedalia and Liberty Theatres. Among other things, the complaint alleged that, because of activities of the defendants and their co-conspirators, Mrs. Carter suffered operating losses, was unable to sell or lease her properties at a fair price, and was compelled to give up

[1] Prior to November 7, 1940, Mrs. Carter owned an undivided one-half interest in the theatres and operated them in partnership with the other owners; thereafter she was the sole owner and operator (R. 9–10; Supp. R. 6).

her right to operate the theatre business "and to thus earn the reward and profits which said business and properties were capable of earning and producing and which, except for such unlawful conduct of defendants and their co-conspirators would have been earned and received by her." With respect to damages, the complaint alleged that "the business and property consisting of said Liberty Theatre and Sedalia Theatre, in Sedalia, Missouri, has been greatly injured and damaged by reason of which plaintiff has lost income, profits, business, property and investments in at least the sum of $500,000.00." Accordingly, the plaintiff trust asked judgment against the defendant motion picture companies in the amount of $1,500,000, together with attorneys' fees, costs and expenses (Supp. R. 9–10).

At the pre-trial proceedings the plaintiff's claim for damages in the anti-trust suit was explained as being limited to profits lost by reason of the defendants' action (Supp. R. 18–19). When Mabel K. Carter died, Gilbert Carter succeeded her as trustee of the Mabel K. Carter Trust and as plaintiff in the anti-trust suit.[2] On March 31, 1955, he executed an "Agreement" and "Release" which stated that the anti-trust suit was being settled for $600,000, with payment to be made over a number of years (R. 10; Supp. R. 11–13). In accordance with the settlement, he received, as trustee of the Mabel K.

[2] Mabel K. Carter died on May 18, 1954, and Emma M. Vollrath died on June 20, 1953. On July 7, 1954, the Probate Court for Vernon County, Missouri, granted letters testamentary in the Estate of Mabel K. Carter and the Estate of Emma M. Vollrath to Gilbert Carter (R. 7; Supp. R. 5).

Carter Trust, net amounts of $105,272.56 and $127,925.20 during the taxable years 1955 and 1956, respectively, which he distributed to the beneficiaries of the trust (R. 10; Supp. R. 15).

In 1956, one of the taxpayers, David Carter, succeeded to all of Emma M. Vollrath's interest and to one-fourth of Mabel K. Carter's interest under their respective wills. In 1956 he received from the trustee distributions in respect of the interests he acquired from Emma M. Vollrath and Mabel K. Carter, as well as the interest he already owned (R. 10-11; Supp. R. 15). In 1956 Gilbert Carter succeeded to one-fourth of Mabel K. Carter's interest in the trust. During that year he received from the trustee distributions in respect of the interest he acquired from Mabel K. Carter and the interest he already owned (R. 11; Supp. R. 15–16).

ARGUMENT

The primary issue here involves a question of fact on which the concurrent findings of the two courts below are final. *Comstock* v. *Group of Investors*, 335 U.S. 211, 214. Contrary to taxpayers' assertions, there is no conflict of decisions or other reason for further review of the case by this Court.

1. The two courts below found that the settlement proceeds of the anti-trust suit represented damages for loss of profits which was taxable as ordinary income. Taxpayers, on the other hand, contend (Pet. 12–25) that the proceeds resulted from the involuntary conversion of capital assets, taxable as capital gain under Section 1231 of the 1954 Code (see *infra*, pp. 13–14).

a. It is well established that the taxability of the proceeds of a lawsuit depends on what the proceeds represent. *E.g., United States* v. *Safety Car Heating Co.*, 297 U.S. 88; *Durkee* v. *Commissioner*, 162 F. 2d 184 (C.A. 6); *Raytheon Production Corp.* v. *Commissioner*, 144 F. 2d 110 (C.A. 1), certiorari denied, 323 U.S. 779. The latter two decisions hold that if the settlement proceeds in an anti-trust action represent restitution for loss of profits, they are taxable, and, if they represent restitution for loss of capital, such as for the destruction of or injury to the good will of a business, they are not taxable except to the extent that the amount of the proceeds exceeds the cost of the asset. Those propositions, despite the taxpayers' contentions to the contrary (Pet. 12–13), are not in dispute in the present case. Taxpayers concede that the settlement proceeds were taxable (Supp. R. 19) and that "the good will here and the business of which it was a part had a basis of zero" (Pet. 23–24). The issue in this case, which is analogous to that in *Durkee* and *Raytheon Production Corp.*, is whether the settlement proceeds, as a matter of fact, represented loss of profits and were therefore taxable as ordinary income or represented the conversion of a capital asset within the meaning of Section 1231 (*infra*, pp. 13–14) and were therefore taxable as capital gain.

b. On this factual question the determination of the two courts below is clearly correct. The evidence shows, indisputably, that the claim for damages in the anti-trust suit was based on profits lost by Mrs. Carter and, therefore, that the settlement proceeds represented recovery of lost profits (and perhaps punitive

damages") (see Supp. R. 9–10, 18–19). Taxpayers have not seriously denied this. Their claim has been (see Supp. R. 19–21; Pet. A4) that loss of profits was merely the measure of damages for the destruction of Mrs. Carter's theatre business, meaning the good will of the business. But the Tax Court found, and properly so on the evidence, that Mrs. Carter's "going business" of operating her theatres had not been profitable and never acquired any good will or value as an operating enterprise (Supp. R. 16, 21–22). The court of appeals concurred (Pet. A4–A5), stating (Pet. A5) that no evidence was offered in the anti-trust suit or before the Tax Court "as to the 'going concern value' or 'good will' value, *qua* good will of the Liberty Theatre business."[3]

2. The taxpayers, who inherited interests in the Mabel K. Carter Trust, claim (Pet. 27–32) that they were entitled to an adjusted basis which they could deduct from the settlement proceeds they received. This contention, which involves the application of

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[3] Taxpayers argue (Pet. 24–25) that punitive damages are not involved here. Neither court below affirmatively held that they were; they merely recognized the proposition that any portion of the proceeds which represented punitive damages was taxable as ordinary income. *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426.

[4] Contrary to taxpayers' assertion (Pet. 25–27), they were not denied proper appellate review of the Tax Court's decision. The opinion below follows the principles set forth in *Commissioner* v. *Duberstein*, 363 U.S. 278 (Pet. A6–A8). The court found no error "factual or legal" which would warrant reversal (Pet. A8) and from its examination of the record concluded that "the facts as found by the Tax Court are entirely accurate and fair" (Pet. A2). Both courts below examined the pertinent evidence in detail.

Sections 1014 and 691 of the 1954 Code (Appendix, *infra*, pp. 11–13), is also without merit.

Although Section 1014(a) provides that the basis of inherited property shall be its fair market value at the decedent's death, subsection (c) of that section expressly states that the section does not apply "to property which constitutes a right to receive an item of income in respect of a decedent under section 691." The latter section provides that the amount of all items of gross income in respect of a decedent which are not properly includible in the taxable period of death or a prior period shall be included in the gross income of the estate or heir for the taxable period when received. Section 691 further provides that the right to receive such an item of income shall be treated as having the same character in the hands of the estate or heir as it would have had in the hands of the decedent if the decedent had lived and received such amount. Since there is no question that the settlement proceeds would have been income to Mrs. Carter, they are likewise income to the taxpayers under Section 691. Accordingly, the basis provided in Section 1014(a) is inapplicable.

Taxpayers' argument (Pet. 28–29) is based on a contention that Section 691 does not apply to an unliquidated claim that was uncertain as to right and amount. But Section 1.691(a)–1(b)(3) of Treasury Regulations on Income Tax (1954 Code) (Appendix, *infra*, pp. 14–15) expressly provides that Section 691 covers "Income to which the decedent had a contingent claim at the time of his death." Accord, Rev.

Rul. 55–463, 1955–2 Cum. Bull. 277. This regulation is reasonable and fully consistent with Section 691.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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MAY 1962.

APPENDIX

Internal Revenue Code of 1954:

SEC. 691. RECIPIENTS OF INCOME IN RESPECT OF DECEDENTS.

(a) *Inclusion in Gross Income.*—

(1) *General rule.*—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period (including the amount of all items of gross income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequests, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent:

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inherit-

ance, if the amount is received after a distribution by the decedent's estate of such right.

(2) *Income in case of sale, etc.*—If a right, described in paragraph (1), to receive an amount is transferred by the estate of the decedent or a person who received such right by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent, there shall be included in the gross income of the estate or such person, as the case may be, for the taxable period in which the transfer occurs, the fair market value of such right at the time of such transfer plus the amount by which any consideration for the transfer exceeds such fair market value. For purposes of this paragraph, the term "transfer" includes sale, exchange, or other disposition, or the satisfaction of an installment obligation at other than face value, but does not include transmission at death to the estate of the decedent or a transfer to a person pursuant to the right of such person to receive such amount by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent.

(3) *Character of income determined by reference to decedent.*—The right, described in paragraph (1), to receive an amount shall be treated, in the hands of the estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction in which the right to re-

ceive the income was originally derived and the amount includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

* * * * *

SEC. 1014. BASIS OF PROPERTY ACQUIRED FROM A DECEDENT.

(a) *In General.*—Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be the fair market value of the property at the date of the decedent's death, or * * *.

* * * * *

(c) *Property Representing Income in Respect of a Decedent.*—This section shall not apply to property which constitutes a right to receive an item of income in respect of a decedent under section 691.

* * * * *

SEC. 1231. PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS.

(a) *General Rule.*—If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an

exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For purposes of this subsection—

(1) in determining under this subsection whether gains exceed losses, the gains described therein shall be included only if and to the extent taken into account in computing gross income and the losses described therein shall be included only if and to the extent taken into account in computing taxable income, except that section 1211 shall not apply; and

(2) losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

* * * * *

Treasury Regulations on Income Tax (1954 Code):

Sec. 1.691(a)-1. *Income in Respect of a Decedent.*— * * *

(b) *General definition.*—In general, the term "income in respect of a decedent" refers to those

amounts to which a decedent was entitled as gross income but which were not properly includible in computing his taxable income for the taxable year ending with the date of his death or for a previous taxable year under the method of accounting employed by the decedent. See the regulations under section 451. Thus, the term includes:

(1) All accrued income of a decedent who reported his income by use of the cash receipts and disbursements method;

(2) Income accrued solely by reason of the decedent's death in case of a decedent who reports his income by use of an accrual method of accounting; and

(3) Income to which the decedent had a contingent claim at the time of his death.

See sections 736 and 753 and the regulations thereunder for "income in respect of a decedent" in the case of a deceased partner.

Sec. 1.691(a)-2. *Inclusion in Gross Income by Recipients.*—(a) Under section 691(a)(1), income in respect of a decedent shall be included in the gross income for the taxable year when received, of—

(1) The estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(2) The person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(3) The person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the

amount is received after a distribution by the decedent's estate of such right.

These amounts are included in the income of the estate or of such persons when received by them whether or not they report income by use of the cash receipts and disbursements method.

* * * * *

Sec. 1.691(a)-3. *Character of Gross Income.*—(a) The right to receive an amount of income in respect of a decedent shall be treated in the hands of the estate, or by the person entitled to receive such amount by bequest, devise, or inheritance from the decedent or by reason of his death, as if it had been acquired in the transaction by which the decedent (or a prior decedent) acquired such right, and shall be considered as having the same character it would have had if the decedent (or a prior decedent) had lived and received such amount. The provisions of section 1014(a), relating to the basis of property acquired from a decedent, do not apply to these amounts in the hands of the estate and such persons. See section 1014(c).

(b) The application of paragraph (a) of this section may be illustrated by the following:

(1) If the income would have been capital gain to the decedent, if he had lived and had received it, from the sale of property held for more than 6 months, the income, when received, shall be treated in the hands of the estate or of such person as capital gain from the sale of the property, held for more than 6 months, in the same manner as if such person had held

the property for the period the decedent held it, and had made the sale.

(2) If the income is interest on United States obligations which were owned by the decedent, such income shall be treated as interest on United States obligations in the hands of the person receiving it, for the purpose of determining the credit provided by section 35, as if such person had owned the obligations with respect to which such interest is paid.

* * * * * *

Sec. 1.691(a)-4. *Transfer of Right to Income in Respect of a Decedent.*—(a) Section 691(a)(2) provides the rules governing the treatment of income in respect of a decedent (or a prior decedent) in the event a right to receive such income is transferred by the estate or person entitled thereto by bequest, devise, or inheritance, or by reason of the death of the decedent. In general, the transferor must include in his gross income for the taxable period in which the transfer occurs the amount of the consideration, if any, received for the right or the fair market value of the right at the time of the transfer, whichever is greater. Thus, upon a sale of such right by the estate or person entitled to receive it, the fair market value of the right or the amount received upon the sale, whichever is greater, is included in the gross income of the vendor. Similarly, if such right is disposed of by gift, the fair market value of the right at the time of the gift must be included in the gross income of the donor. In the case of a satisfaction of an installment obligation at other than face value,

which is likewise considered a transfer under section 691(a)(2), see § 1.691(a)-5.

(b) If the estate of a decedent or any person transmits the right to income in respect of a decedent to another who would be required by section 691(a)(1) to include such income when received in his gross income, only the transferee will include such income when received in his gross income. In this situation, a transfer within the meaning of section 691(a)(2) has not occurred. This paragraph may be illustrated by the following:

(1) If a person entitled to income in respect of a decedent dies before receiving such income, only his estate or other person entitled to such income by bequest, devise, or inheritance from the latter decedent, or by reason of the death of the latter decedent, must include such amount in gross income when received.

(2) If a right to income in respect of a decedent is transferred by an estate to a specific or residuary legatee, only the specific or residuary legatee must include such income in gross income when received.

(3) If a trust to which is bequeathed a right of a decedent to certain payments of income terminates and transfers the right to a beneficiary, only the beneficiary must include such income in gross income when received.

If the transferee described in subparagraphs (1), (2), and (3) of this paragraph transfers his right to receive the amounts in the manner described in paragraph (a) of this section, the principles contained in paragraph (a) are ap-

plied to such transfer. On the other hand, if the transferee transmits his right in the manner described in this paragraph, the principles of this paragraph are again applied to such transfer.

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